Economic Outlook

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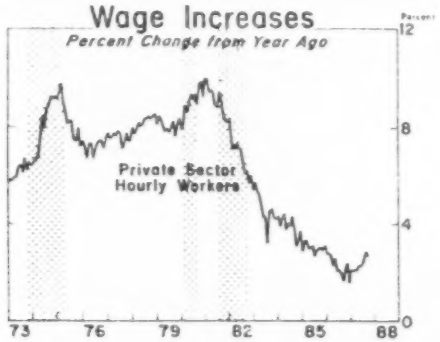
The strength in the economy continues to exceed most analysts' expectations. Manufacturing is leading the way, creating more than twice as many jobs in the third quarter as it added altogether in the three prior quarters. The lower dollar is stimulating this robust expansion with exports growing at double-digit rates. The overall increase in employment has buoyed consumer confidence to the highest levels in nearly 15 years, suggesting that forecasts of the consumer's demise are greatly exaggerated. While higher interest rates have dampened the outlook for housing and construction in general, the strong labor market and healthy corporate profits will continue to drive the economy ahead.

As economists have realized the underlying strength in the economy, concern has shifted toward the outlook for inflation. Until recently, most forecasters were taking solace from the sluggishness in wage growth. Weakened unions, deregulation, corporate restructuring, and earlier weakness in manufacturing have helped hold down wage growth in this expansion. But the current upward momentum in the labor market, where unemployment and initial claims for unemployment insurance are now running at the lowest levels since the 1970s, suggests the tide has turned on the wage inflation front. In fact, the year-over-year growth in wages bottomed out late last year with inflation, interest rates, economic growth, and manufacturing activity.



Some have minimized the pickup in wage inflation this year because it remains low in comparison with the 1970s. But the important point is that it is rising. While wage growth was less than three percent from September 1986 to September 1987, it picked up sharply in the third quarter, especially in the retail trade, mining, manufacturing, and finance sectors. As shown in the table, the retail trade sector exhibits the largest pickup in hourly earnings growth, reflecting the developing shortage of younger part-time workers. The third quarter acceleration in manufacturing wage growth reinforces the picture of accumulating strength in that sector. In addition, the recovery in manufacturing is spilling over into the mining sector, where a year of surging product prices has begun to contribute to increased labor demand and wages. The only sector showing a significant wage deceleration in the third quarter was construction, where higher interest rates and an oversupply of office buildings have slowed activity.

Hourly Earnings Index
(percentage change at annual rate)

	Sept 1986-June 1987	June 1987-Sept 1987
Retail Trade	1.1	5.6
Mining	0.0	4.2
Manufacturing	1.5	5.1
All Sectors	2.4	4.2
Finance, Insurance & Real Estate	4.5	5.5
Services	4.0	4.1
Wholesale Trade	2.9	3.0
Transport & Public Utilities	3.0	2.8
Construction	2.7	-1.5

There is no force on the immediate horizon sufficient to offset the underlying momentum in the economy. As a result, the trend in wages will continue upward. While still a far cry from the levels of the early eighties, inflation will continue to move up as wages begin to contribute to the pickup already ignited by the rapid growth of crude material prices.

Robert T. McGee

Real GNP

(Percent Contribution to Real GNP Growth; Annual Rates)	Actual 1986 III	Actual 1986 IV	Actual 1987 I	Actual 1987 II	Forecast 1987 III	Forecast 1987 IV	Forecast 1988 I	Forecast 1988 II	Actual 1985-1986	Forecast 1986-1987	Forecast 1987-1988
Consumer Spending	4.7	0.3	-0.5	1.2	3.2	0.5	1.3	1.3	2.7	1.3	1.4
Business Investment	-0.4	0.6	-1.9	1.3	1.0	0.6	0.6	0.5	-0.3	-0.1	0.7
Residential Investment	0.5	0.1	-0.4	-0.2	-0.1	-0.2	-0.1	-0.1	0.6	0.0	-0.1
Change in Inventories*	-3.1	-0.1	4.4	-1.6	-1.7	0.6	0.1	0.2	0.0	0.1	-0.3
Net Exports	-1.6	1.1	1.8	0.3	0.2	1.3	0.8	0.8	-1.0	0.5	0.7
Government Purchases*	1.3	-0.5	1.0	1.5	0.9	0.7	0.5	0.6	0.9	0.9	0.8
Real GNP	1.4	1.5	4.4	2.5	3.5	3.5	3.2	3.3	2.9	2.7	3.2

Quarterly Economic Indicators

(Percent Changes at Annual Rates)	Actual 1986 III	Actual 1986 IV	Actual 1987 I	Actual 1987 II	Forecast 1987 III	Forecast 1987 IV	Forecast 1988 I	Forecast 1988 II	Actual 1985-1986	Forecast 1986-1987	Forecast 1987-1988
Nominal GNP	5.3	2.1	8.6	6.3	7.5	8.1	8.4	8.9	5.6	6.0	8.3
GNP Deflator	3.6	0.7	4.2	3.5	3.9	4.5	4.9	5.4	2.6	3.2	4.9
Corporate Profits After Tax#	0.4	-0.3	6.7	9.9	6.3	6.3	12.5	10.1	-1.0	7.3	9.5

Monthly Economic Indicators

	Recent Data Jun.	Recent Data Jul.	Recent Data Aug.	Actual 1986	Forecast 1987	Forecast 1988
Consumer Price Index** (%)	0.4	0.2	0.5	1.1	5.2	6.1
Industrial Production (%)	0.7	0.8	0.3	1.0	3.6	4.3
Retail Sales (%)	1.2	0.5	1.3	5.5	3.8	4.1
Auto Sales (million units, a.r.)	10.0	10.5	12.4	11.5	10.3	10.0
Housing Starts (million units, a.r.)	1.59	1.61	1.58	1.81	1.65	1.58
Unemployment Rate (%)	6.1	6.0	6.0	7.0	6.2	5.6
Merchandise Trade Deficit ($ bn., a.r.)	-188.5	-197.7	-188.2	-156.2	-155.0	-135.0

*Adjusted for CCC purchases. **Annual percent changes are December to December.
#Quarterly data are year-over-year percent changes.
a.r.=annual rate F=Forecast